

## Internal Revenue Service

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PLR-127002-14

Date:

December 10, 2014

### Legend

A =

B =

Trust =

State =

Dear

This letter responds to a letter from your authorized representative dated July 11, 2014, and subsequent correspondence submitted on behalf of Trust, requesting rulings that (1) Trust's income is excludable from gross income under Internal Revenue Code ("IRC") § 115 and (2) Trust is not required to file an annual federal income tax return under IRC § 6012(a)(4). Trust represents the facts as follows:

### FACTS

A is a governmental entity and political subdivision of State. B, the governing body of A, established Trust to provide a prefunding source for the payment of liabilities for health and welfare benefits to retired employees of A and their eligible spouses and dependents.

Trust will receive contributions from A as needed to fund Trust. Trust assets will be used for the exclusive purpose of providing retiree health and welfare benefits and for defraying reasonable administrative and actuarial expenses. Under no circumstances

will the assets be used for, or diverted to, any other purpose, except as permitted under IRC § 115 and other applicable law.

The Trust is governed by a Board of Trustees composed of 5 members. Three of the trustees are members of B, the governing body of A, and two hold managerial positions with A. The Board of Trustees has investment authority over the Trust funds, including the authority to invest funds in investments permitted by State law.

Trust may be dissolved by A. However, upon termination of Trust, any remaining assets will be used to provide health and welfare benefits to retirees and their eligible spouses and dependents. Any assets remaining in Trust after satisfying all benefit obligations may be paid to A to the extent consistent with IRC § 115. In no event will Trust's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excluded from its gross income by application of IRC § 115.

#### Issue 1- IRC § 115(1)

### LAW AND ANALYSIS

IRC §115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC § 115(1), because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC § 115(1) because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excluded from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization.

The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

The provision of these health and welfare benefits by A constitutes the performance of an essential government function within the meaning of IRC § 115(1). See Rev. Rul. 90-74 and Rev. Rul. 77-261.

No private interests will participate in, or benefit from, the operation of Trust other than as providers of goods or services. The benefit to retirees and eligible spouses and dependents is incidental to the public benefit. See Rev. Rul. 90-74.

In no event, including dissolution, will Trust's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excluded from its gross income by application of IRC § 115.

As stated above, Trust was formed for the sole purpose of providing a prefunding source for the payment of liabilities for health and welfare benefits to retirees and eligible spouses and dependents of A.

Trust's dedication of its corpus and income exclusively for the benefit of the retirees of A and their dependents satisfies an obligation of A to provide health and welfare benefits to its retired employees. The benefit to A's participating retirees, spouses, and their dependents is incidental to the public benefit. Upon termination, all of Trust's assets must be used for funding the postemployment benefits offered by A or administrative expenses. Any remaining assets will be distributed to A, a political subdivision of State.

#### Issue 2 – IRC § 6012(a)(4)

### LAW AND ANALYSIS

Section 301.7701-1(b) of the Procedure and Administration Regulations provides, in part, that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through 301.7701-4(a), unless a provision of the IRC provides for special treatment of that organization.

Section 301.7701-4(a) provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Contributions to Trust are to be used to prefund health care coverage and related administrative costs for certain retirees and their dependents. Board is charged with the

responsibility of protecting and conserving Trust property for the benefit of beneficiaries of Trust pursuant to State law. Beneficiaries of Trust cannot share in the discharge of Board's responsibility for the protection and conservation of Trust property and, therefore, are not associates in a joint enterprise for the conduct of a business for profit.

IRC § 6012(a)(4) provides that every trust having taxable income for the tax year, or income, must file a return with respect to income taxes under subtitle A.

## RULINGS

Based solely on the facts and representations submitted by Trust:

1. Because the income of Trust is derived from the exercise of an essential governmental function and will accrue to a political subdivision or to an entity the income of which is excludable from gross income under the provisions of IRC § 115(1), we rule that Trust's income is excludable from gross income under IRC § 115(1).
2. We conclude that Trust is classified as a trust within the meaning of IRC § 7701(a) and § 301.7701-4(a). IRC § 6012(a)(4) does not require a trust without taxable income to make a return of income when gross income is less than \$600. Because Trust's income is excludable from gross income under IRC § 115(1), we rule that Trust is not required by IRC § 6012(a)(4) to file an annual income tax return.

No opinion is expressed concerning the Federal tax consequences under any IRC provision other than the one specifically cited above. In particular, no representation is made that contributions or premiums paid on behalf of or benefits received by employees, former employees, retirees, spouses, dependents or others will be tax-free. This ruling concerns only the Federal tax treatment of Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or IRC § 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to state or any political subdivision thereof.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Casey L. Lothamer  
Senior Technician Reviewer  
(Tax Exempt & Government Entities)

Enclosure (1)